Financing the Future: Medicare + Choice in the 21th Century

AAHP 2002 Medicare & Medicaid Conference
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Thank you for the invitation to address your 2002 conference.

I must admit, however, to some trepidation for three reasons. First, it is tough being the last speaker of the day, you've already heard it all. Second, you see I know that one of my former bosses – Bob Reischauer – was supposed to give this address and competing with Bob on this subject is impossible. But third and probably most disconcerting, once I realized that many of you are directly involved in the Medicare + Choice program, my discomfort level peaked. Because I was one of the staff who worked on the Balanced Budget Act of 1997 which set the framework for the new Medicare+Choice program. But I need not tell this group that ever since BBA the program has been beset with plan withdrawals and declining enrollment. I'm here to tell you its not my fault!

Looking for some good news, however, in one of his recent surveys, the irrepressible Robert Blendon found that the proportion of Americans who view managed care companies as doing a good job for their consumers, while still low at 33 percent, is nonetheless up slightly from the figure prior to the September 11 attacks last year.[2] Further, I hope you all have noticed that according to a recent report from the Campaign Media Analysis Group – crooked executives have replaced cigarette pushers and heartless HMOs as the star bogeymen in the political attack ads out so far this fall. It wasn't that long ago that the simple mention of managed care in Hollywood movies or on television monologues moved viewers to laughter and tears. Even Ron Pollack of Families USA observed on the recent passage of the Senate's generic drug bill that its passage was "a reflection of drug industry now having surpassed the managed-care industry as everyone's whipping boy." I guess you should be thankful for at least these small advances in the world of political acceptance – even if it is at the expense of somebody else.

Let me be serious. I do not mean to make light of the situation. Beginning with Alain Enthoven's pro-competitive health care proposals in the late 1970's and followed by Aaron and

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[1]Staff Director, Committee on the Budget, U. S. Senate, Washington, D.C. The views and opinions are those of the author and do not necessarily reflect the views and opinions of the Ranking Member, the Chairman or other Committee members or staff.

[2]R. J. Blendon, John T. Young, Catherine M. DesRoches, and John Benson, "The Continuing Legacy of Septemeber 11 for Americans' Health Priorities"; Health Affairs, August 14, 2002.

Reischauer's notion of a premium support Medicare system in 1995, Medicare managed care plans have been seen as the primary alternative to the traditional fee-for-service program. The Balanced Budget Act of 1997 dramatically expanded the goals and expectations of the Medicare risk-contracting program, and the National Bipartisan Commission on the Future of Medicare, (also created by the BBA) and whose recommendations came within one vote of being adopted, had as their central proposition: the future of Medicare would be one that empowered beneficiaries to choose from among competing comprehensive health plans in a system based on a blend of existing government protections and market-based competition. That proposition was correct with the Enthoven plan nearly 30 years ago, it was true with the BBA 5 years ago, it is correct today, and it is correct for the future.

Before I focus on the future of Medicare+Choice, I have been requested to provide an update of the federal budget.

You have already heard and will continue to hear from health-care experts about various Medicare and Medicaid legislative options. At a more fundamental level, all these options must address the basic question of how much a nation is willing to expend for health care and at what cost to other competing goods and services. Today in the United States we devote a significant share of our national economy to health care. In fact, according to the OECD review of its 20 members' countries and the *Economist's* annual survey of over 173 countries around the world, no country matches the U.S. in the share of its economy devoted to health expenditures – 13 percent in 2000.[3] Hard to believe but little Nicaragua comes in second at 12.2 percent.

I do not believe that any health care system, public or private, can ever meet the demands for medical care when combined with the rapid advances in medical technology, particularly if the products being produced are viewed by the patient as free or close to being free. The question then of how to allocate public and private resources in a fair and efficient manner is not just limited to health care but to all the other myriad and competing public and private demands. This is the essence of budgeting, and I guess after nearly 30 years at public budgeting I am still inclined to believe that it can be done in a rational problem solving way.

At least for today, in the give and tug of priorities, according to Harris polls over the last year, health care has dropped as a priority. Last August before the attacks, health care was viewed by 14 percent of all Americans as one of the two most important issues for government to address, that figure fell to only 3 percent in October after the attacks, and has come back in most recent surveys to about 9 percent, but still well below the 37% who ranked terrorism and economy as the most pressing issues today. We all know those priorities can change rapidly, and if terrorism were to decline as an issue, then health care would surely emerge again as a top

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[3] *Health at a Glance,* OECD 2001. *Pocket World in Figures*, 2002 Edition, The Economist.

concern.[4] In the near term, however, the current focus on the war and the budget outlook, complicates, and could delay, the sizeable health care agenda that is boiling just below the surface of these other priorities.

The Federal Budget Outlook

First the very near term, for the current federal fiscal year that will end in 20 days, the federal government will post a deficit of nearly $160 billion. As early as last March, the outlook was still a balanced budget, albeit very small, both for this year and next. So what happened?

Budget Outlook for FY 2002 & FY 2003
In Billions of Dollars

Total Surplus or Deficit (-) [CBO March 2002]	5.2	6.3
Changes Enacted to Date		
Job Creation and Worker Assistance Act of 2002	50.8	42.9
FY 2002 Supplemental	5.9	22.6
Farm Security and Rural Investment Act of 2002	1.6	8.4
Spectrum Auctions	0.0	2.6
Interest on Legislative Changes	0.6	3.8
Subtotal, Changes to Date	58.9	80.3
Other Changes		
FY 2003 Appropriations– President's Request	0.0	24.7
Revenue Shortfall	103.2	83.5
Interest, Economic, and Technical	1.1	-4.4
Subtotal, Other Changes	103.1	96.3
Total Changes	162.1	176.6
Revised Total Surplus or Deficit (-)	-156.9	-170.3
Memo: On-Budget Surplus or Deficit (-)	-313.9	-340.2

Source: The Budget and Economic Outlook, CBO August 2002. Senate Budget Committee, GOP staff estimates.

The turn around in the country's fiscal stance is nothing but astonishing. Last year, the federal government recorded a budget surplus of $127 billion or 1.3 percent of GDP. This year's $157 billion deficit represents 1.5 percent of GDP. That's a 2.8 percentage point swing in 12 months in the fiscal status of this country. In times of war and economic downturns, deficit spending is not unusual, and we have had deficits that have exceeded this level in the not to distant past. However, I can not find in the historical records going back to the 1930's when we have ever had a swing from surplus to deficits of this order of magnitude in a one year period.

[4]R.J. Blendon et al., op.cit..

The factors that have driven us back into the red in the near term result from the unprecedented events of this last year. They are not, as the political rhetoric would lead some to believe because of the tax cuts of last year. Even if last year's legislated, tax cuts had not taken place we would still be in a deficit this year by over $120 billion. The factors that have put us back in a deficit relate to the emergency spending required after the attacks a year ago tomorrow morning, increased national security spending to execute the war in Afghanistan, and a new economic stimulus bill enacted last winter. But the biggest factor in turning the tables on us was an unexpected drop off in revenues, again not from those legislated tax cuts but those resulting from the bursting of the bubble on the stock market. We experienced a loss of over $100 billion in receipts from what was expected just 8 months ago due to the rapid economic downturn – primarily from capital gains receipts, stock options, and other stock market driven income.

Budget Expenditures Through July

Major Category	October-July		Percentage Change	
	FY2001	FY2002	Actual	Adjusted[a]
Defense—Military	239	273	14.3	12.9
Social Security Benefits	354	372	5.2	5.2
Medicare	197	212	7.9	9.5
Medicaid	108	123	13.5	13.5
Unemployment Insurance	26	45	73.9	73.9
Other Programs and Activities	432	512	18.4	14.0
Subtotal	1,355	1,537	13.4	12.0
Net Interest on the Public Debt	183	150	-18.1	-18.1
Total	1,538	1,686	9.6	8.5

a. Excludes the effects of payments that were shifted because of weekends, holidays, or legislative action. Also excludes the July 2001 credit reestimate for spectrum loans, which was largely reversed last September.

Source: CBO's Monthly Budget Review (August 9, 2002)

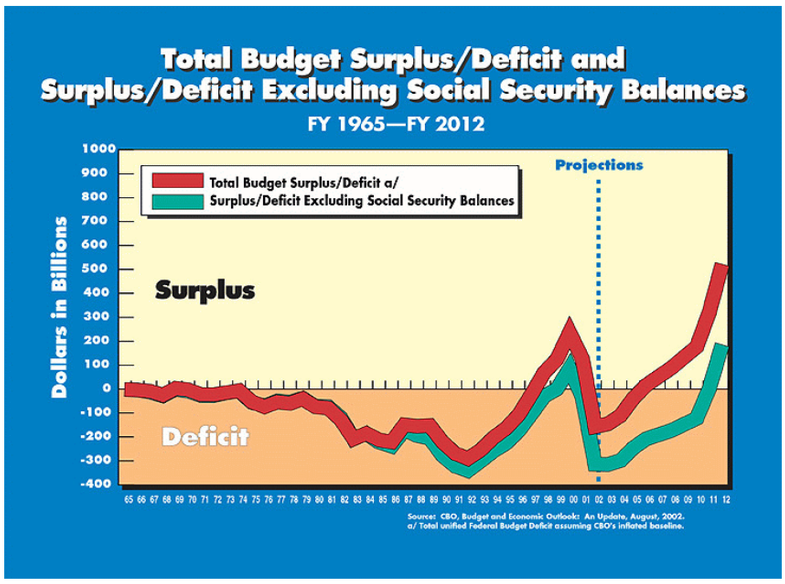
More specific to this audience, federal spending overall has increased over the last 12 months – about 8.5 percent. Excluding interest payments that have declined because of reduced debt these last 5 years, all other federal spending has grown 12 percent this last year. It is true that defense spending along with unemployment insurance have been the fastest growing programs this last year, but Medicare and Medicaid combined have also grown at an annual rate of nearly 10 percent.

For the new fiscal year 2003 that begins in 20 days, the outlook is not necessarily any more promising. The President's own Mid-Session review in July projects a $109 billion deficit

next year assuming the President's policies are enacted.[5] One policy that the President assumes will be enacted this fall is a policy to "strengthen Medicare" and increase Medicare spending $50 billion over current law over the next five years. Within this $50 billion "add-back" is $3.3 billion for Medicare+Choice programs.

The Congressional Budget Office (CBO) recently released its updated pre-policy estimate of the budget for next year, and as has been widely reported, they see red ink reaching nearly $150 billion next year and surpluses not returning until 2006. But this is probably a best case scenario, since just completing the policies that the President has requested of this Congress – increased defense and homeland security spending, Medicare add-backs, extension of some expiring tax provisions – would add another $30 billion to the deficit next year.

Chart 3 graphically lays out the current CBO projections over the next decade. Again these estimates assume that current policies are maintained, and we know that will not be the case. These pre-policy estimates are a benchmark for the cost of legislative proposals to be judged against in the near term and over the next decade, that is if anybody cares about fiscal policy. Toward the middle of this decade surpluses would reemerge and cumulatively total about $1.0 trillion under these latest estimates – but 80 percent of this $1.0 trillion would occur in the last two years of the projection period, 2011-2012. But excluding social security surpluses, the rest of government remains in deficit through 2011.



[5]The Administration's Mid-Session "baseline" or pre-policy estimate of the deficit for FY 2003 is $62 billion, with balance being achieved in FY 2004 of $17 billion. Presidential policies, however, add to the baseline deficit in FY 2003 nearly $47 billion primarily due to defense and homeland security spending, and balance is not achieved until FY 2005 with a post-policy surplus estimate of $53 billion.

Federal budgeting, it has been observed, does not have a long time horizon. Annual appropriations are enforceable only on a one-year basis, if then. Congressmen elected for two years, Senators for six years, and President's for four years, most all have difficulty focusing on those policies that impact beyond their next election. Finally, economists and budgeteers have recently had difficulty making projections that can stand up from one session of Congress to the next, thus increasing the skepticism and undermining their credibility for making significant policy decisions. In the memorable words of Yogi Barra, "Predictions are difficult, particularly about the future."

But of all the variables that budget estimators must take into consideration and that lead to fluctuations in their estimates, the one that doesn't vary is the aging process. Whatever can be said or not said about the level of GDP ten years from now, or the level of inflation or unemployment, I am certain of one thing, in 10 years I will be 10 years older as will millions of my fellow generation born post- World War II. Despite this fact that is generally understood, the short-term trumps the long-term in budgeting and thoughtful policies linked to the aging process suffer.

The outgoing CBO Director, my friend and colleague Dan Crippen, has made as one of his cause celebre' in his last few months as Director this issue of the looming budgetary impact from an aging society. In a series of long-range fiscal policy briefs this summer and fall he has laid out these trends and their implications. I borrow heavily from those briefs with these comments.[6]

The "baby boom" and the "baby trough" are events that have taken place – we need not guess about them. The baby boom has helped to fuel the economic expansion of the last two decades as the boomers entered their peak, productive working years. But this is about to end. Recently the Aspen Institute released a study that pointed out the simple fact that: from 1980 to 2000, nearly 30 million new native-born workers age 25-54 provided the workforce needed for a growing economy.[7] Unbelievable, but from now until 2021, there will be no additional native-born workers in this prime age group, zero. Any growth in the labor force these next 20 years will have to come from older workers and immigrants. These may not be, relative to native-born, college educated, prime age workers, the most productive workers unless they receive special attention with education and training and retraining programs.

I make this point only as it relates to productivity. The key assumption going into the future for all these long-term estimates is productivity growing at 1.6 percent annually. Sounds imminently doable based on past trends. Past work force demographic trends will not, however, be the case. Productivity growth cannot be assumed without public resources being allocated to training and education.

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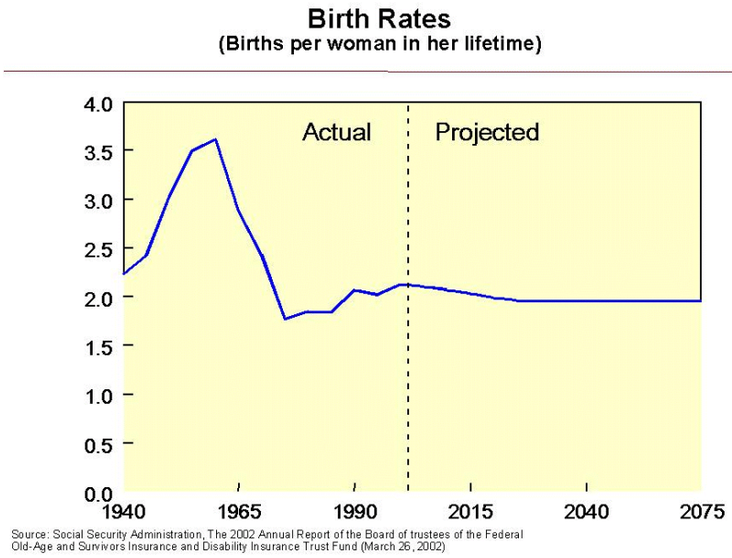
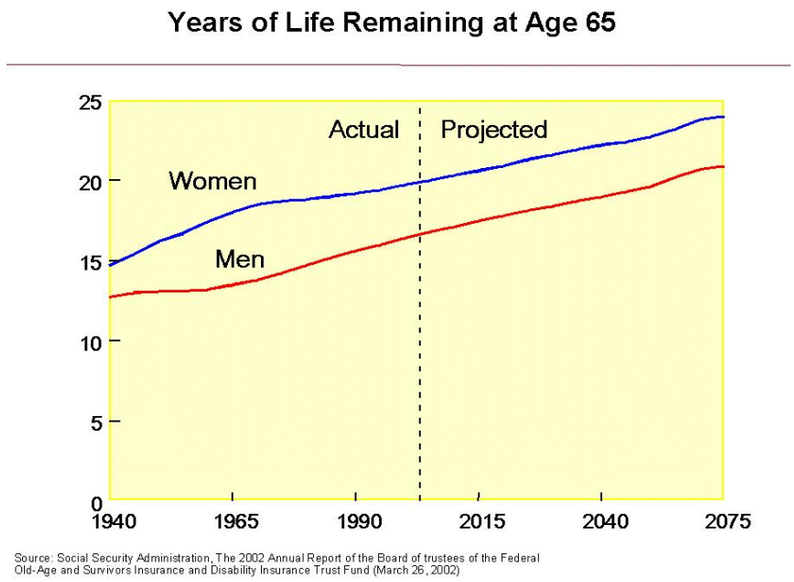
[6] *A 125-Year Picture of the Federal Government's Share of the Economy, 1950-2075*, June 14, 2002; *The Looming Budgetary Impact of Society's Aging*, July 3, 2002; *Social Security and the Federal Budget: The Necessity of Maintaining a Comprehensive Long-Range Perspective;* Congressional Budget Office, Long Range Fiscal Policy Briefs .

[7] "Grow Faster Together or Grow Faster Apart" Aspen Institute, Domestic Strategy Group; September 1, 2002.



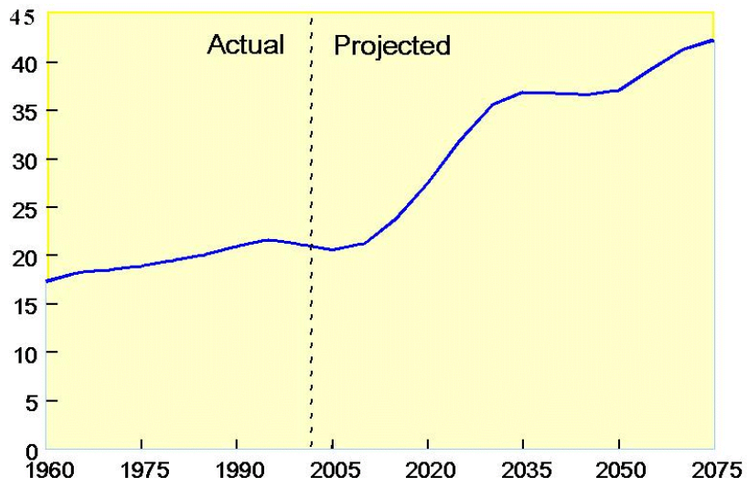
At the same time, the wonders of modern drug therapies and medical technology have combined to increase life expectancy. On average, based on Social Security Actuarial estimates today, if you are female and 40 years old today and you make it to 65 – you can expect to reach 87 years. Similarly if you are male and 40 years old today you can expect to reach 83 years. If you are 55 today and female and you can make another 10 years, expect then to reach 85 and similarly if male expect to reach 82.



Between now and 2010, the population 65+ will remain virtually unchanged at 21 percent of the total population between the ages of 20-64. This is commonly referred to as the dependency ratio. But when you combine these two demographic phenomena – birth rates and longevity --

shortly after this current 10-year budget window, the number of persons over 65 will grow rapidly. Today there are an estimated 36 million persons over 65 years of age and in the normal 10-year budget window, in 2010 that number will have increased slightly to 39 million. But in next 10 year budget window between 2010 and 2020, the number of persons over 65 explodes to 53 million and by 2035 the number will have doubled to over 74 million or 37 percent of the population between the ages of 20-64.

The Population Age 65 or Older as a Percentage of the Population Age 20 to 64 (Percent)



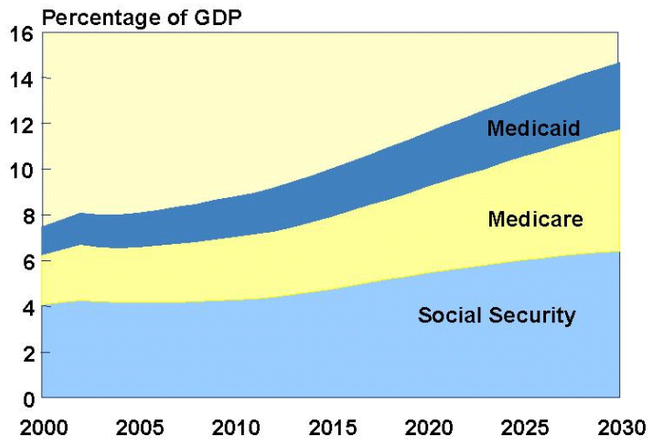
Source: Social Security Administration, The 2002 Annual Report of the Board of trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Fund (March 26, 2002)

Federal spending under current law looks relatively benign over the next 10 years, in fact without any changes in current policy, spending might even decline slightly as a share of the entire economy from 18.5 percent in 2000 to 17.4 percent in 2010. And if the economy were to begin a rapid recovery and another boom like the 1990's, the share might even be lower. If this were to occur, then the temptation might be with growing surpluses to either reduce future tax burdens or increase spending on – a growing but not yet retired politically powerful population – the boomers. Wrong answer!

Surprise, surprise. When you now combine the looming aging population with the existing major entitlement programs of social security, Medicare, and Medicaid, and if you assume all the rest of federal spending (excluding interest payments) remains roughly the same share of GDP, federal spending explodes after the current 10-year budget window. By 2035 social security, Medicare and Medicaid would make up 70 percent of all non-interest federal spending, and by 2075 all federal revenues would be absorbed by these three programs.

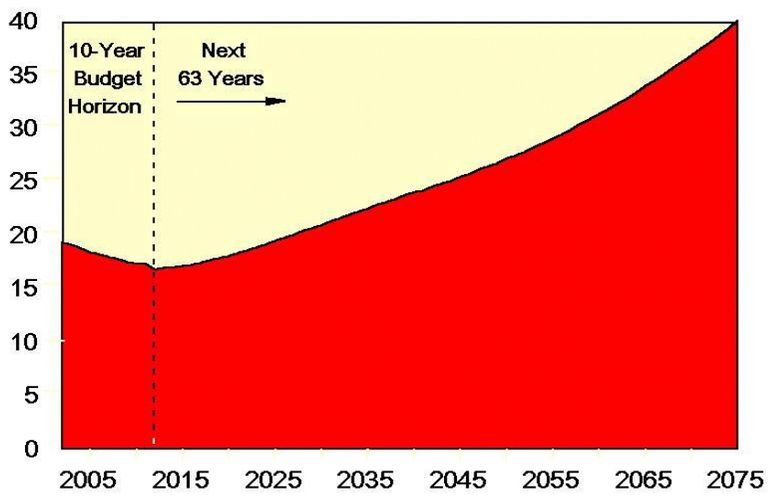
I remind all of you, this assumes current law social security, Medicare and Medicaid. It does not assume a new expensive prescription drug benefit being added onto the existing Medicare program.

Spending for Social Security, Medicare, and Medicaid, 2000-2030



Source: CBO based on its midrange assumptions about growth of GDP and program spending.
For further details, see *The Budget and Economic Outlook*: FY03-FY12 (January 2002), Chapter 6

Federal Outlays, 2002-2075
(As a Percentage of GDP)



Source: The Looming Budgetary Impact of Society's Aging. Congressional Budget Office (July 3, 2002)

But we don't have to wait until 2075 for the pressure to grow on federal resources. Spending on the big three entitlement programs of Social Security, Medicare, and Medicaid as a share of the

national income will virtually double. Expenditures for these three programs will grow from 7.8 percent today to 14.7 percent by 2030.

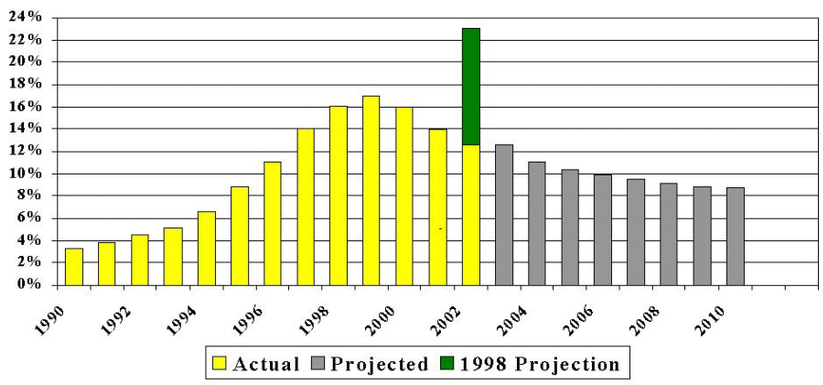
Financing the Future: Medicare + Choice in the 21th Century

Given this federal budget outlook what does it all mean for the future of Medicare+ Choice? I want to present my conclusion in two parts, the near term defined as the last few days of this 107th Congress and then the longer term, beyond the 10-year budget window. It's a mixed message.

First, I, like many others who have tried to diagnose Medicare + Choice since the Balanced Budget Act of 1997, find that in general we failed to accomplish the two fundamental goals established for the program: (1) provide beneficiaries with more choice of health care plans, and (2) help control the growth of Medicare spending.

The failure to achieve the Congressional goals simultaneously was in part because the two goals were at odds with each other. Controlling costs while providing broader benefits for beneficiaries so as to expand coverage in managed care settings, were conflicting goals at the very time other market forces were at work in the health care sector. The Congress wanted to take advantage of the efficiencies to be gained by managed care, but it was not able to find a way to share those efficiencies in a way that both attracted beneficiaries to the program and limited government spending. As the former HCFA Administrator observed early last year: "As a vehicle for the future, Medicare + Choice had inconsistent goals and terrible timing."

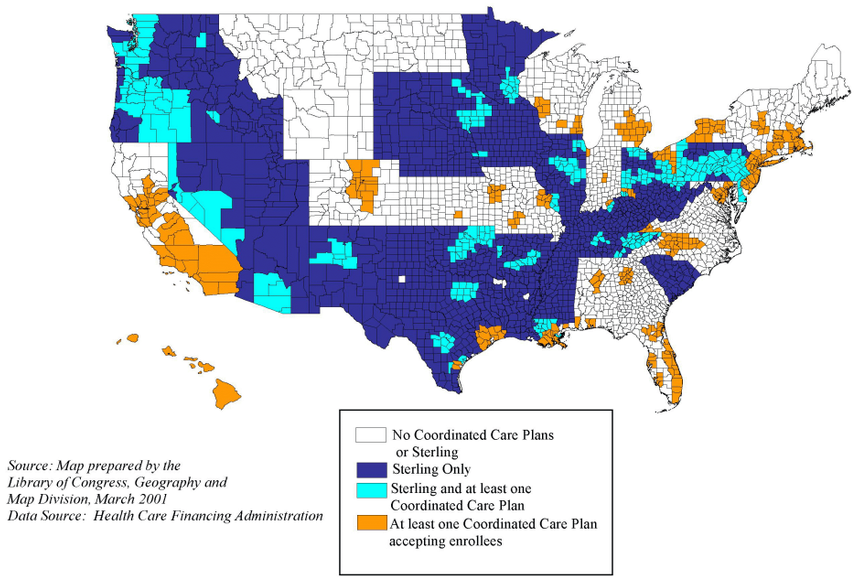
Percent of Beneficiaries Enrolled in Medicare Managed Care Plans, Actual and Projected, 1990-2012



Source: Prepared by CRS based on MedPAC Chart Book, Oct. 1997, Chapter 3. CMS, Medical Managed Care Plan Monthly Summary Reports, Dec. 1998, 1998, 2000, 2001, and Aug. 2002 Baseline for Projections
Note: Medicare Managed Care Plans include risk plans through 1998 and Medicare+ Choice plans beginning in 1999

Further, the obstacles to a market-based system in a monopolistic or oligopolistic rural environment with limited providers will always create problems for expanding managed care into

rural areas. The problems of health care services in the rural sections of our country relate to far more fundamental issues than what simply a delivery system based on competition can ever be expected to overcome.



Source: Map prepared by the Library of Congress, Geography and Map Division, March 2001
Data Source: Health Care Financing Administration

Since the BBA withdrawals from the program have most often been attributed to limited payment rate increases. Indeed since 1997, twice Congress has tried to stem the tide of plan terminations or shrinkages by increasing payment rates, and we may increase them again this year. My boss, Senator Domenici, has been at the forefront in supporting these increases particularly with the 2000 Benefits Improvement Protection Act provisions to assist small urban areas.

But at the risk of being stoned here, I have to tell you that my research reading in preparing for this conference leads me to conclude that plan withdrawals since the BBA were not solely due to inadequate reimbursement rates. Increasing payment rates have not stemmed and will not stem plan withdrawals significantly in the near term. The factors involved in withdrawals and therefore for considering policies to expand the program are much more complicated than just the level of reimbursement. Sure with unlimited public resources we could go back to the late 1980's and early 1990's and fix monthly payments that guaranteed profits and participation but also were viewed as inefficient in allocating taxpayers' dollars.

I am struck by the fact that managed care in the general population held down health care spending in the early 1990's, and thereby helped to usher in an expansion of this mode of delivery. But the confluence, the bad timing if you like, of positive market conditions before the BBA's passage, followed by declining market conditions post BBA, especially rising health care costs, specifically prescription drug costs, and an out of sync commercial insurance underwriting cycle, intensified the impact of BBA policy changes. According to the Center for Health Care Change, "this

collision of public policy and private market forces, rather than policy changes alone, brought Medicare + Choice to a halt."[8]

Nonetheless, as we close out the 107th Congress in the next few months, and most likely return after the elections for a "lame-duck" session, reimbursement rate increases for Medicare + Choice plans will be considered. The House has already passed nearly $30 billion in "give backs" for the Medicare program over the next decade; $3 billion for Medicare + Choice plans by increasing reimbursement rates to 100 percent of average per capita fee-for-service rates, plus increasing the minimum update from 2 percent to 3 percent next year. The Senate has not acted, but "add-backs" I believe will be considered either in another run at prescription drug legislation later this fall in the Senate, possibly in any conference with the House on the Senate-passed generic drug bill, or as an amendment to the must do appropriation bills for next year. Given that the President's own budget proposals for next year endorsed such increases for Medicare+Choice, these expenditures appear to escape the fiscal discipline pressure he has imposed on other components of the budget this fall.

In the longer-term, thinking back on the budget outlook, one might conclude that all is lost, but I don't think so. The wonderful economist, the late Herb Stein used to say looking at dire forecasts about the budget: "if something cannot go on forever, it will stop." Applied to the long term outlook of the budget and the unsustainable path placed on future public resources, reform is inevitable in the Medicare program. The key to the future of Medicare + Choice is to be an integrated part of that reform.

In the near term for those beneficiaries who continue to have available to them the Medicare + Choice program, the distinction with the traditional Medicare fee-for-service will be blurred as benefits are reduced and premiums and cost sharing rise. As long as Mediare + Choice payment rates are linked to the fee-for-service, as Congress is likely to do this year with the 100 percent proposal, then current plans may survive marginally but they will not thrive. The future has to be first a delinking from the traditional program's payment structure, and a reform of the traditional system a'la the premium support and market-based system proposed by the National Commission on the Future of Medicare.

The future of Medicare in general and the future of Medicare + Choice specifically, given the budget outlook, I believe lies in the nascent infrastructure now in place for managed care plans. That infrastructure must be maintained and the principles of the original Medicare + Choice program supported by policy makers, because it will become the basis for a modern Medicare program of the future. The current Medicare fee-for-service program will become unsustainable both economically and politically with escalating tax increases and reductions in other government programs to support it. Medical malpractice insurance reform will be necessary; and by reforming the Medicare+ Choice system to incorporate competitive bidding in setting rates, current plans will be well placed in the transition to a premium support, market based Medicare program of the future.

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[8]*Reversal of Fortune: Medicare+Choice Collides with Market Forces.* Joy M. Grossman, Bradley C. Strunk, Rober E. Hurley. Issue Brief No. 52 . Health System Change.